OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM DEBORAH A. BUTLER
ASSISTANT CHIEF COUNSEL (FIELD SERVICE) CC:DOM:FS

SUBJECT:
Like Kind Exchange between Parent and Subsidiary

This Field Service Advice responds to your request dated January 13, 1999, wherein you asked that we reconsider aspects of our earlier advice of November 25, 1996, regarding the subject taxpayer. This Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document may not be cited as precedent.

LEGEND:

Taxpayer	=	.
Corp. A	=	
X	=	
Y	=	
Equipment	=	
Year 1	=	

ISSUE:

Whether the Service can take the position that an exchange of certain equipment among corporations within Taxpayer's consolidated group does not qualify as a tax-free exchange under I.R.C. § 1031.

CONCLUSION:

The Service could correctly, as a matter of law and policy, challenge nonrecognition treatment here and assert that the transactions involved do not qualify under section 1031.

FACTS:

Taxpayer owns, operates, leases and sells Equipment and Equipment parts. In Year 1, Taxpayer and Corp. A entered into an agreement for the sale of Y used Equipment. The transfer of X of that used Equipment is in issue here.

Taxpayer's basis in the Equipment had been substantially reduced by depreciation over the years by the time it had agreed to sell the used Equipment to Corp. A. Thus, purportedly, in order to avoid a large gain on the sale of this Equipment, Taxpayer entered into "tax-free" exchange agreements with two of its subsidiaries whereby the used Equipment of Taxpayer was swapped for certain new Equipment recently purchased directly by the subsidiaries from an individual shareholder.

The new Equipment had a relatively high basis compared to the long-depreciated basis of the old Equipment. The subsidiaries then transferred the Equipment to Corp. A to satisfy Taxpayer's obligation under the sales agreement with Corp A. The subsidiaries apparently recognized and reported the minimal gain made on the transfer to Corp. A of the old Equipment (which now carried a much higher basis in the hands of the subsidiaries). If allowed, therefore, the transaction enabled Taxpayer to avoid the large gain inherent in a direct sale of its used Equipment as well as to escape any required recapture of depreciation taken on that Equipment.

LAW AND ANALYSIS:

Section 1031(a) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business, or for investment, if such property is exchanged solely for property of a like kind which is also to be held for productive use in a trade or business or for investment. The "touchstone" of section 1031 is the requirement that "there be an exchange of like-kind properties rather than a cash sale" and reinvestment of proceeds. Young v. Commissioner, T.C. Memo. 1985-221.

An exchange is not limited to reciprocal transfers between two parties. Multiple-party and "accommodating" party exchanges are certainly allowed.[1] Where a party acts as a mere conduit or agent for the taxpayer, however, the exchange is not cognizable under section 1031. Coupe v. Commissioner, 52 T.C. 394, at 406 (1969). Similarly, passing the property to a "sham" or "strawman" also fails the test. See Garcia v. Commissioner, 80 T.C. 491, at 500-01 (1983).

As we discussed in our earlier memorandum, Congress has recognized the inherent tax-avoidance motivations of exactly the type of transaction presented here. It passed section 1031(f) to end those possibilities by requiring a longer holding period for the related party swap to be allowed nonrecognition. Section 1031(f), however, was not in effect for the year in issue; consequently, it is unavailable to challenge this deal. We note also that even under new section 1031(f), related party exchanges are not universally barred. Such swaps merely carry a longer holding requirement.

Where a wholly-owned subsidiary purchased new trucks from a manufacturer, while its parent sold its used trucks to the same manufacturer, the transaction was treated as merely a tax-free exchange between the related corporations and not as a separate sale and purchase. Redwing Carriers, Inc. v. Tomlinson, 399 F.2d 652 (5th Cir. 1968). In Redwing Carriers, it was the Government successfully seeking to invoke section 1031 treatment. The swapping parties' interrelationship, however, was never made an issue.

There are numerous other instances where related parties attempting to effect a section 1031 transaction went unchallenged on that particular ground. See, e.g., Coastal Terminals, Inc. v. United States, 320 F.2d 333 (4th Cir 1963); Rev. Rul. 72-151, 1972-1 C.B. 225 (sole shareholder and corporation); Rev. Rul. 72-601, 1972-2 C.B. 467 (father and son). Moreover, in Boise Cascade Corp. v. Commissioner, T.C. Memo. 1974-315, the Service argued, and the court's opinion acknowledged, that the parent/subsidiary relationship of the swapping parties in and of itself had no effect on the availability of section 1031 treatment to the transaction involved.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

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[1] In the accommodating buyer cases, the buyer, under taxpayer's specific direction, buys the property that the taxpayer wishes to acquire before the exchange takes place. In those circumstances, the exchange qualifies under section 1031 for the taxpayer but not with respect to the accommodating buyer. That is because the buyer did not acquire the property it eventually passed on to the taxpayer with the requisite holding intent. Rev. Rul. 77-297, 1977-2 C.B. 304.

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[2] [redacted]

[3] [redacted]

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By: _____
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